CHAUTAUQUA CAPITAL MANAGEMENT
A DIVISION OF BAIRD

From Chautauqua Capital Management
A Division of Robert W. Baird

International and Global Growth Equity Strategies

4th Quarter 2016

Introduction

The fourth quarter of 2016 represented the completion of an 11 year performance record for the Chautauqua Capital International Growth Strategy and a 10 year performance record for the Chautauqua Capital Global Growth strategy. Over this time period, as the investment process has been consistently applied, the portfolios have exhibited certain traits. The portfolio generally holds up well when growth styles are not in favor, for example. This past quarter however, it did not. Rather, we have just turned in one of the worst periods of relative performance in the long history of our performance. We are deeply disappointed by these results and we would expect that our clients are too. How did this happen?

The quarter began with a shift from the growth style preference of the third quarter to a value style preference. This appeared to be a short-term reversal, which has been typical in the "risk on risk off" markets of the past 8 years. Then, in early November, despite polls predicting up to 24 hours prior the opposite, Donald Trump became the surprise winner of the U.S. Presidency. The subsequent market rally, based upon the expectation of U.S. fiscal stimulus, deregulation, and improved profits (due to lower tax rates assured by a unified Republican Federal Government, combined with Fed rate hikes), took off, leaving large capitalization, quality growth investors (like us) behind.

In this environment, the Chautauqua Capital International Growth Equity composite declined 6.19%, underperforming the MSCI ACWI ex-U.S. Index®, which declined by 1.20%, and underperforming the MSCI EAFE Index®, which declined 0.68%. The Chautauqua Capital Global Growth Equity composite declined 5.50%, underperforming the MSCI ACWI Index®, which increased 1.30%.

Review

For the MSCI ACWI ex-U.S. Index®, value style outperformed growth style. Within emerging markets, growth style outperformed value style. Small capitalization stocks outperformed large capitalization stocks in all but the emerging market indices. For the MSCI EAFE Index®, value style outperformed growth style, and small capitalization stocks outperformed large capitalization stocks.

For the MSCI ACWI Index®, value style outperformed growth style, and small capitalization stocks outperformed large capitalization stocks. Within emerging markets, growth style outperformed value style, and large capitalization stocks outperformed small capitalization stocks.

Performance by country, in which the portfolios were invested and as measured by MSCI, is as follows: Brazil 2.20%, Canada 3.43%, China -7.07%, Denmark -8.69%, France 3.05%, Germany 1.45%, Hong Kong -8.97%, Ireland 0.15%, Italy 10.82%, Japan -0.14%, Korea -5.28%, Netherlands -2.07%, South Africa -3.97%, Spain 2.31%, Switzerland -3.86%, Taiwan -2.16%, U.K. -0.88% and U.S. 3.54%.

Sector performance was similarly dispersed, with economically sensitive sectors generally outperforming economically defensive sectors. The best performing sectors were financials 12.32%, energy 7.61% and

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materials 3.13%. The worst performing sectors were consumer staples -5.90%, health care -5.38% and telecom -2.22%.

Chautauqua Capital's investment approach focuses on companies that are faster growing, more profitable, and higher quality than the index averages. However, the performance gap between growth and value stocks in the past quarter was just enormous, and so it is cold comfort that our underperformance was not alone among large capitalization growth investors.

Following the U.S. presidential election and solid showing of the Republican Party in Congress, the market rally showed the markings of an early stage bull market. U.S. markets registered their highest level of monthly dispersion since May 2009, this time, with small capitalization and deep value stocks leading returns. Perhaps this could have been expected, with a fresh injection of fiscal stimulus and corporate tax cuts now likely by the next administration. But there is also a worrisome disconnect: such stimulus would be enacted eight years into a bull market, which rallied 180% from early 2009, and has coincided with robust economic expansion, with a GDP expansion of more than 25% over 32 quarters and strengthening of the labor market, with the U.S. unemployment rate falling from more than 10% to 4.6% by the end of 2016. Therefore, viewed in this light, the duration and magnitude of the bull market and economic expansion call into question why the markets rallied the way they did in the fourth quarter and what that rally portends for the future, given current market levels. Is it possible that too much optimism is already priced in?

Add to this the threat of protectionism and the promise of deregulation, and you will get varied fortunes for different portions of the market. Our large capitalization portfolios are generally invested in advantaged companies with off-shore operations, advanced supply chains and worldwide sales channels. Naturally, these are the types of businesses that will be negatively impacted by protectionism. Furthermore, deregulation effectively dulls their advantage with respect to regulatory compliance and lobbying, both of which stem from size and greater access to resources. Smaller businesses, on the other hand, are less impacted by protectionism and benefit much more from deregulation.

The U.S. dollar also strengthened on the back of looming fiscal stimulus and corporate tax cuts. Moreover, the Federal Reserve indicated that it will move back to a normal monetary policy, expecting to hike interest rates in several iterations. Dollar strength is disadvantageous to larger businesses, which own U.S. operations and then export their finished products to weaker currency countries. These businesses can cut prices to foreign customers, which lowers profit margins, or maintain prices but risk lower volumes and loss of market share. In contrast, smaller businesses tend to benefit from a strong dollar, which allows them to purchase cheaper inputs outside the U.S. and then sell their finished products to their mostly domestic customers.

The biggest beneficiary of potential fiscal stimulus and higher interest rates is undoubtedly the financial sector. Under zero interest rate policy, banks treaded water as the interest spread between what they charge borrowers and what they pay to depositors compressed to historic lows. Any increase in interest rates would be beneficial for the sector. Some basic materials industries also rallied in anticipation of early stage economic activity, while the energy sector was seen as a beneficiary of potentially looser regulation.

Brent crude oil, which bottomed at $27 per barrel in January 2016, rallied during the quarter to $57 per barrel. Oil producers are a mix of independent and national players, which at times have different agendas. In the long run, they all seek to maximize the value of their assets, but in the short run, national oil companies may take counterproductive actions.

Saudi Arabia and Iran are regional rivals. As sanctions were lifted on Iran in 2015, Iran began to restart its oil export business. To thwart its nemesis, Saudi Arabia ramped up its production, putting downward pressure on prices. While the aim for Saudi Arabia was to preserve its market position, the oversupply they created also caused a great deal of self-harm. Because of lower oil prices, Saudi Arabia dug itself into a budget deficit that was 13.5% of its gross domestic product (GDP) and impaired the value of the initial public offering prospects for the state-owned oil company Saudi Aramco.

Accordingly, when Saudi Arabia met with the members of the Organization of Petroleum Exporting Countries (OPEC) during the fourth quarter, they took a more conciliatory tone and pledged to take the biggest production cutback among the major producers. The Saudis also cajoled non-OPEC members, such as Russia, to reduce production by 300,000 barrels per day. U.S. independent producers have been able to reduce their production costs during the low price environment and are expected to increase production as oil prices rise.

Portfolio Highlights

Chautauqua Capital trailed the benchmarks in each of the three months of the quarter. Geographic exposures did not play a major role in the underperformance. The level of underperformance was actually mitigated by the sector diversity of the portfolios, which included significant weights in energy and financials, which is distinctive among growth style managers.

Most holdings reported earnings during the quarter. Of these, 68% reported results that exceeded expectations. Of the 32% that missed earnings, most were due the inclusion of extraordinary items or from the deferral of revenue from this to the next quarter as a result of conservative revenue recognition standards. From an operating level, the fundamentals of the companies are quite sound. This was one of the rare quarters when conviction-weighting did not contribute to our success. The top five positions aggregate weight was very similar to the aggregate weight of the bottom five weighted positions.

Performance Attribution

In a quarter where market leadership rotated sharply to the aforementioned value style preference, the International Growth Equity portfolio trailed the benchmark during the quarter. The portfolio's significant overweight to leading, high quality health care and information technology companies held back returns from a sector perspective, as both sectors sold off sharply during the quarter. However, the portfolio's intentional underweight to the weakest performing sector, consumer staples, and to the utilities sector was additive to returns. In addition, the portfolio's slight overweight to energy, given our disciplined approach to sector diversification, combined with positive stock selection in the energy sector was additive to performance. In direct contrast to the third quarter, stock selection in Asian and the Pacific Basin was the largest detractor on a regional basis. The level of underperformance was mitigated by portfolio reductions in the region following the U.S. Presidential election.

The Global Growth Equity portfolio trailed the benchmark. Stock selection accounted for a majority of the underperformance vs. the MSCI ACWI index, given the market's overwhelming preference for value style securities. On a regional basis, 60% of the contribution came from North America with 30% from Asia and the Pacific Basin. From a sector standpoint, stock selection and over weights in health care and information technology held back returns. Of note, the leadership rotation away from consumer staples and utilities aided performance, given our underweights to these sectors. While we have select investments in the consumer staples sector, we find it difficult to find high-quality growth companies that meet our rigorous growth and valuation requirements.

Composite performance for the periods ending December 31, 2016*

International

	Q4 2016	1 Year	3 Year	5 Year	Since Inception 1/1/06	Cumulative Since Inception 1/1/06
International Growth Equity - Gross	**-6.19%**	**-0.09%**	**1.66%**	**6.22%**	**6.44%**	**98.77%**
International Growth Equity - Net	**-6.31%**	**-0.52%**	**1.26%**	**5.78%**	**6.22%**	**94.21%**
MSCI ACWI ex-U.S. Index® - GD	-1.20%	5.01%	-1.32%	5.48%	3.53%	46.43%
MSCI EAFE Index® - GD	-0.68%	1.51%	-1.15%	7.02%	3.32%	43.23%

Global

	Q4 2016	1 Year	3 Year	5 Year	Since Inception 1/1/07	Cumulative Since Inception 1/1/07
Global Growth Equity - Gross	**-5.50%**	**2.24%**	**6.66%**	**10.83%**	**7.30%**	**102.28%**
Global Growth Equity - Net	**-5.67%**	**1.67%**	**6.08%**	**10.27%**	**7.00%**	**96.77%**
MSCI ACWI Index® -GD	1.30%	8.49%	3.69%	9.96%	4.12%	49.75%
MSCI World Index® - GD	1.97%	8.15%	4.38%	11.04%	4.41%	54.02%

***These are preliminary figures from our portfolio accounting system that have yet to be verified by Ashland Partners.**

Outlook

Some have called 2016 the year of the underdog. The improbable have prevailed from the passage of Brexit and the election of Donald Trump, to Leicester's win of England's Premier Soccer League and the Cubs' first World Series title in 108 years.

In 2016, Chautauqua Capital generated returns well in excess of the benchmark for the first three quarters and then suffered a relative performance shortfall in the fourth quarter that more than erased those gains. This performance loss was improbable and deeply painful. Frustratingly, the only thing that would have enabled the retention of outperformance in the fourth quarter would have been a wholesale rotation out of large capitalization, quality growth stocks in favor of small capitalization, low quality value stocks. After eighteen years of successfully deploying this investment process, and eleven years in international markets, we are confident that such a change would be a mistake.

We believe that there is simply no better way to generate superior risk-adjusted returns over a multi-year time horizon than the way we do it. As a matter of fact, the recent underperformance by large capitalization, quality growth stocks has created one of those occasional opportunities to acquire positions in advantaged companies that benefit from secular growth trends at relatively attractive prices. We hold many of them as investments, while others are now appearing on our screens. But in all cases, we must consider the potential headwinds and tailwinds that are likely to impact share prices over our investment horizon. To our view, there is a lot to be worried about.

For one, we are concerned by the rise of populism and nationalism. Trump's victory is just one instance of what is sweeping the globe. In Italy, voters rejected Prime Minister Matteo Renzi's proposals to reform the Italian government, which led to his resignation. Meanwhile, the opposing Five Star Movement, led by comedian Beppo Grillo, intends to take Italy out of the euro-zone. In Russia, President Vladimir Putin continues to engage in small military adventures, invoking nationalism. The global refugee crisis, stemming in part from the Syrian Civil war and incidents of terror by Islamist fundamentalist groups, is creating a strong anti-immigration sentiment. In the Philippines, President Rodrigo Duterte has focused his agenda on fighting drug-related corruption but has undermined due process in favor of vigilante justice. In China, President Xi has ratcheted up the Chinese propaganda machine and is challenging maritime borders. Meanwhile, in Japan, Prime Minister Shinzo Abe is increasing his country's defense spending. Trade deals have been scuttled, and the Trans Pacific Partnership has no chance of being approved by the U.S.

Given the current mood, Europe's election super cycle looks risky as establishment candidates in several countries face populist opposition. Germany will hold their presidential election on February 12 and their general election, which determines the legislature, in September. Chancellor Angela Merkel has begun to appeal to anti-Muslim sentiment by calling for restrictions on Burqas as her coalition has started to fray. The Netherlands will hold general elections on March 15. Geert Wilders, a self-proclaimed right-wing liberal who has compared the Quran to Hitler's Mein Kampf and the leader of the Party for Freedom, is currently leading in the polls. France will hold their presidential elections on April 23 and May 7. Right wing populist Marine Le Pen is currently polling to win the first round.

Longer term, euro-zone countries will need to acquiesce to a central body for fiscal policy. The current paradigm, which upholds the political and monetary union, fails to prescribe spending and tax policies of member countries. In its current incomplete form, this sets the stage for a continual pattern of bailouts for members who run up deficits and let their government debt reach unmanageable levels.

The U.S. election has already been impactful. President-elect Donald Trump made a bevy of campaign promises – not limited to spending $1 trillion through his 10-year infrastructure proposal, cutting corporate and personal income taxes, abolishing the Affordable Care Act, deregulating the financial services and energy sectors rescinding trade deals, building a wall along the U.S.-Mexico border and expelling 11 million undocumented immigrants. These promises may have helped him galvanize support among his base, and though they will be difficult to keep, they will be imperative to watch. Some estimate that fiscal stimulus will add to the budget deficit and add $7 trillion to the already significant national debt. And with Fed rate hikes, the cost of servicing this debt will consume an ever larger portion of the budget.

Meanwhile, the U.S. Federal Reserve has renewed the process of monetary tightening, with the aim of returning the Federal funds rate to a normal level above the rate of inflation. Achieving this will be necessary so that the Federal Reserve can implement monetary stimulus when needed again in the future.

Therefore, as this plays out in 2017, the U.S. economy will be impacted by simultaneous fiscal stimulus and monetary tightening. Further, the burst of growth in the U.S. should provide an engine to the rest of the world. Initially, the fiscal stimulus will be an adrenaline shot to the U.S. economy, and we expect U.S. GDP growth to accelerate in 2017. But since the economy is already at or near its output potential, the effects to this spending will raise the rate of inflation and may lead to over capacity.

We expect that the U.S. dollar will continue to strengthen in 2017; this will have ripple effects in the global economy. Absent a coordinated adjustment, the yen and the euro will plummet against the dollar. Therefore, the Bank of Japan and the European Central Bank may have to begin their own tightening cycles much sooner than expected by abandoning their asset-buying programs and raising bank borrowing rates. Bank of America Merrill Lynch estimates that nearly $4 trillion of debt in Europe yields negative interest rates, and we expect negative yield bonds will become an interesting relic of an unusual time.

Already, high dividend yield stocks have begun to decline in price as yield-oriented investors will be able to go straight to the bond markets for income generation. Separately, dollar-denominated debt issuances, which have gained popularity in recent years by both foreign governments and companies, will be imperiled. We have been careful to avoid owning companies with significant amounts of dollar-denominated debt, knowing that debt service costs would rerate higher and could hamstring the business. U.S. protectionism and a strong dollar will be challenging for the emerging markets. Within our investable universe in the emerging markets, we can selectively identify advantaged companies that are fundamentally sound while not impacted by these headwinds and are trading at attractive valuations.

The recent trends that we have utilized continue to remain intact and are robust enough to continue into 2017. Investment ideas related to the demographic demand for medical solutions, to problems that occur with greater frequency with age and the financial service needs of an aging population remain fruitful. We envision a continued migration to web-based solutions be they ecommerce, data storage or applications software related. Labor shortages should appear in some markets owing to low birth rates and the fact that the unemployment rate in places like the U.S. and Japan is already below its long-term average and proposed infrastructure projects will compete for labor at a time that immigrant labor will be turned away. In these markets, rising labor costs could become inflationary. Therefore, we expect companies to continue to automate, and we are invested in this trend through certain portfolio companies.

In the energy sector, the price of oil has risen as excess supply has come into balance with demand. This short-term trend seems promising, but we are not confident that we could predict a target price and date for peak oil prices. Accordingly, we have established positions in companies that are very profitable and have significant growth opportunities with oil as it is priced right now. We will be ever vigilant to monitor macro forces to ensure that we are able to make adjustments if the supply and demand dynamics change.

Being able to maneuver in a turbulent geopolitical world will be key to our investment success in 2017. Having a cohesive and collaborative team of six veteran investors will be in our favor. Managing a concentrated, conviction-weighted portfolio of approximately 40 securities in the Global strategy and 30 securities in the International strategy enables us to be more nimble. First and foremost however, we benefit from owning companies which themselves can navigate challenging times. These well capitalized businesses, which enjoy pricing power and the ability to focus their business in the most opportune places in the world, tend to maintain their margins and grow their market share as lesser competitors grapple to adapt. The equity market dislocation of the last quarter is actually presenting us with more opportunities and we continue to evaluate compelling ideas.

Business Update

There have been no changes to the investment staff at Chautauqua Capital nor have there been any changes to the ownership structure with our parent Robert W. Baird.

Respectfully submitted,

The Partners of Chautauqua Capital Management – a Division of Robert W. Baird

The above commentary does not provide a complete analysis of every material fact regarding any market, industry, security or portfolio. Portfolio holdings information, opinions and other market or economic information and data provided are as of the date of the commentary, unless another date is expressly indicated, and may change without notice. The manager's assessment of a particular industry, security or investment is intended solely to provide insight into the manager's investment process and is not a recommendation to buy or sell any security, nor investment advice.

The MSCI ACWI Index® is a free float-adjusted market capitalization weighted index that is designed to measure the equity performance of developed and emerging markets. The MSCI ACWI Index® consists of 44 country indices, including the United States, comprising 23 developed and 21 emerging market country indices.

The MSCI ACWI ex-U.S. Index® is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed and emerging markets excluding the United States.

The MSCI EAFE Index® is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed markets, excluding the United States and Canada. The MSCI EAFE Index® consists of 21 developed market country indices.

The MSCI World Index® is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed markets. The MSCI World Index® consists of 23 developed market country indices.

Performance results will vary among client accounts. The actual return and value of an account will fluctuate and at any point in time could be worth more or less than the amount invested. The performance results displayed herein represent the investment performance records for the Chautauqua composites that include fully discretionary fee paying client accounts. The composites' returns are total, time weighted returns expressed in U.S. dollars. Composite returns reflect the reinvestment of dividends and other earnings. The net performance reflects the deduction of investment advisory fees and transactions costs and the gross performance is net of transaction costs, but gross of advisory fees. The cumulative performance information shown is the aggregate amount that the composites have gained since inception through December 31, 2016.

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Chautauqua Capital Management Investment Team

- All investment team members have equity ownership
- Average years of experience: 21 years

Investment Professional	Degrees	Years of Experience	Prior Affiliation
Brian Beitner, CFA *Managing Partner*	MBA, University of Southern California BS, University of Southern California	37	TCW Group Scudder Stevens & Clark Bear Stearns Security Pacific
Daniel Boston *Partner*	MBA, Yale University BS, Brigham Young University	11	Ensign Peak Advisors Artisan Partners Wasatch Advisors
Jesse Flores *Partner*	MBA, Stanford University BS, Cornell University	10	Roth Capital Partners Blavin & Company Lehman Bros.
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David Lubchenco *Partner*	MBA, University of Denver BA, The Colorado College	24	Marsico Capital Management Transamerica Investment Management Janus Capital
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